

LIFE SETTLEMENT ABUSES, PROBLEMS AND FRAUD

CHAPTER 9

Abuses are never good for anyone and certainly they have not helped the young, maturing life settlements industry. But as in any business situation where buyers and sellers joust for best deals and information is not balanced and one side of a transaction knows much more than the other, risk of abuses will exist. The media reports them, regulators hawk for them, and legislators wince on them. It is up to the industry's operators to control and avoid them through self-regulation, establishing "best practices," and shunning of those who through ignorance, laziness, or deliberate action violate legal and ethical guidelines.

Most state laws regulating life settlements require rigorous anti-fraud practices by industry operators. These laws also define unacceptable business and advertising practices. But, not every state has regulations and even those that do cannot anticipate and legislate every type of undesirable behavior that buyers and sellers of life settlements might contrive. This chapter identifies many abusive practices that have occurred, explores their legal ramifications, and most importantly suggests methods to identify, control, avoid them – and when to report them to regulatory authorities.

FRAUD AND FRAUD PREVENTION

Fraud is understood as the intentional deception for the purpose to realize gain at someone else's loss. In the insurance regulatory context, fraud is the intentional violation of an insurance statute or regulation. It is essential to understand that insurance fraud is a *felony* and in many states subjects the perpetrator of the fraud to criminal (or civil) penalties. Life settlement laws have not been as tough, but as of 2008, new laws and amendments to prior laws in numerous states have added severe penalties for fraudulent life settlement transactions and abusive practices of life settlement operators, selling policyholders, and agents and advisors acting as life settlement intermediaries.

Essentially, any act of willful and/or intentional misinformation, misleading information, missing information, or other violation of a life settlement law can be deemed a fraudulent action. So, it is essential that all persons working in a life settlement transaction educate themselves about the life settlement laws and regulations, and operate fairly and transparently throughout the transaction.

General fraud provisions of the insurance codes of the states regulating life settlements are summarized in the table below:

PREDATORY BEHAVIOR

Taking unfair advantage of policyholders and insureds is of paramount concern to legislators and regulators. They try to control predatory practices by setting specific rules for the transaction of business and requirements for consumer protection disclosures to alert the consumer about potential negative consequences that may result from a transaction and are unlikely to be volunteered by the other party to the transaction. The concern exists because of the general lack of knowledge and understanding among consumers in matters of life insurance and life settlements. The following practices are generally considered "predatory:"

- Policy pricing that is unfair and not based on competitive market practices.
- Failure to assure that the policyholder understands all the available alternative options with respect to the decision to "hold" (sell) or "fold" (retain the life insurance policy).
- Use of unclear and unfair life settlement transaction forms and closing documents.
- Making unreasonable promises to the policyholder or insured.

Figure 9.1

TABLE 1 – GENERAL FRAUD PROVISIONS BY STATE		
State	Specific PENALTIES or State’s General Fraud Law	INTENTIONAL only or ANY violation
AR	Criminal	Intentional
CA*	General fraud law	Intentional
CO	Specific to LS/VIS law	Intentional
FL	General fraud law	Intentional
GA	Specific to LS/VIS law	Intentional
HI	specific penalties	Intentional only
IA	Specific to LS/VIS law	Civil action for any violation
IN	Specific to LS/VIS law	Intentional
KS	General fraud law	Intentional
KY	General fraud law	Intentional
LA	Specific to LS/VIS law	Intentional
MD	Specific to LS/VIS law	Intentional
ME	General fraud law	Intentional
MS	General fraud law	Intentional
MT	General fraud law	Intentional
NC	Specific to LS/VIS law	Intentional
NE	Specific to LS/VIS law	Civil action for any violation
NJ	Specific to LS/VIS law	Civil action for any violation
ND	Specific to LS/VIS law	Intentional
NV	Specific to LS/VIS law	Intentional
OH	General fraud law	Intentional
OK	Specific to LS/VIS law	Civil action for any violation
OR	General fraud law	Intentional
PA	Specific to LS/VIS law	Civil action for any violation
UT	Specific to LS/VIS law	Intentional
VA	General fraud law	Intentional
WA*	General fraud law	Civil action for any violation
WI	Specific to LS/VIS law	Civil action for any violation
WV	Specific to LS/VIS law	Criminal action for any violation

* Legislation pending as of June, 2008

- Using the policyholder or insured in some indirect way for the benefit of others.
- Payment of excessive commissions to life settlement intermediaries.

Transaction transparency and prudent business judgment are the best means to flush out predatory practices. Ethical life settlement operators do not want to be connected with predatory business practices, directly or

indirectly. In addition to full disclosure of all transaction details to the policyholder and insured, embracing a “know-your-customer” system is a good practice: call the policyholder and insured directly; ask a few questions and listen for reasonable answers that are either consistent or inconsistent with other information provided by others in the transaction. Focusing on the needs and goals of the client and the client’s family are essential and must always be placed before the interests of the other parties to the transaction.

Discovery of predatory practices by regulators may be cause for discipline of the bad actors, which can include fines and suspension or revocation of state insurance department issued licenses.

SECURITIES VIOLATIONS

Life settlements may or may not be subject to securities laws and regulations. Generally life settlements are subject to insurance laws and regulations. However, *all* variable life insurance policies are securities subject to securities regulations and the Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Authority (FINRA) consider life settlements in which fractional interests are sold to investors to be a security. Life settlements purchased by a single purchaser have so far avoided the classification of a security, but a syndication of the sale of a life settlement portfolio to multiple investors is subject to securities regulations.

Specifically, on March 24, 2008, FINRA issued a letter to all FINRA member firms to “highlight new and existing areas that are of particular significance” with regard to its 2008 exam priorities:¹

FINRA has devoted considerable resources to the topic of senior investors and “baby boomers.” FINRA efforts include educating these investors, firms and registered representatives on key issues surrounding investors in or approaching retirement. FINRA also actively participated in the SEC’s second Seniors Summit (www.sec.gov/spotlight/seniors/seniors_summit.htm), and coordinated examinations with the SEC and certain state securities regulators focusing on sales seminars (www.sec.gov/investor/seniors.shtml). These examinations found significant concerns related to seniors, including sales pitches masquerading as educational seminars, misleading advertising and sales materials, poor supervision, product suitability and outright fraud (www.sec.gov/spotlight/seniors/freelunchreport.pdf). These examinations also found—and a report on these examinations cited—a number of favorable practices implemented by some broker-dealers to ensure compliant practices and investor protection. Please also see *Regulatory Notice 07-43* (www.finra.org/notices/07-43). Senior investors will be the subject of targeted exams where FINRA has significant concerns related to:

- Sales pitches promoted as educational seminars;

- Misleading advertising and sales materials aimed at senior investors;
- Suitability of certain products or arrangements such as life settlements and early withdrawals from retirement accounts; and
- Salesperson designations as experts in the area of senior investors.

Earlier abuses in the securities area involving life settlements were found in firms aggregating life settlement policies and selling fractional interests to small investors. These firms came under fire from federal and state securities regulators claiming they were selling unregistered securities. But based on a 1996 case, *SEC vs Life Partners, Inc.*, in which the U.S. Court of Appeals, D.C. ruled that a sale of a fractionalized interest in a life insurance policy was not a security,² these firms fought back and ploughed ahead. A landmark resolution occurred in 2004 when the SEC seized control of Mutual Benefit Corporation for its violation of securities laws in selling investments in life settlement policies, and all policies held for investors were placed in a receivership for management. Since then, others engaged in selling investments in a portion (as opposed to the whole) of the death benefit of a life settlement policy have been closed by federal or state regulators or law enforcement or have changed their business practices to conform to the requirements of federal and state securities laws.

Clearly, FINRA, the SEC, and state securities regulators are on the lookout for life settlement operators who ignore compliance with securities laws and who use predatory practices involving seniors, who need protection from making risky investments of their life savings and deferred compensation that they need to remain financially capable.

ABUSES AND PROBLEMS BY INDUSTRY OPERATORS

A major focus of state laws and regulations governing life settlements is to prevent abusive business practices, particularly as they apply to seniors who are considering selling or have sold life insurance policies as life settlements. The question is, “what are problems and abusive practices?” Generally, an “abuse” occurs when someone willfully seeks to gain advantage by providing misinformation, delaying progress, or transferring problems to someone else. Some abuses may be classified

as “fraud” in some states, subject to serious penalties. “Problems” generally occur as a result of carelessness, clerical errors, or inadequate discovery and reviews. The following list provides examples of problems and

abusive life settlement business practices that industry operators have caused. There may well be others, and new ones will be invented. However, the industry should exert strong efforts to avoid these practices.

Figure 9.2

TABLE 2 – ABUSES AND PROBLEMS BY INDUSTRY OPERATORS			
	Abuse/Problem	Detection/Avoidance	Legal Ramifications
1	Excess commissions paid to brokers, agents and other intermediaries.	No absolute standard exists, but many investors and providers react negatively to commissions greater than one third of the total amount paid by the investor for a life settlement policy. [Note that in viatical settlements, there are minimum pricing standards, which indirectly caps commissions]	Breach of fiduciary duty or fraud and violation of insurance regulatory law.
2	Agent controls the deal and does not allow the seller to respond to offers, questions, etc. This includes agents who refuse or complain about asking seller to sign transaction documents.	Look for an agent that claims to have a power of attorney for the policyholder and/or insured. Listen for the agent who says “the client does what I say ... therefore the client does not need to be further involved.” Look for signatures that appear inconsistent with official ID documents of the policyholder or insured.	Breach of fiduciary duty or fraud and violation of insurance regulatory law.
3	Agent or broker does not get competitive bids for the seller.	This is direct violation of the fiduciary duty imposed on life settlement brokers under all states with life settlement laws. Listen for the agent or broker who says, “Give me my price <u>and commission</u> , and I can get instant approval of your offer.”	Breach of fiduciary duty or fraud and violation of insurance regulatory law.
4	Providers, and if applicable, brokers operating non-registered or licensed in states where such is required.	Ask for copies of licenses and/or check state registrations. Be alert to operators who claim to operate only in non-regulated states. Verify the policy seller’s state of residence.	Violation of insurance regulatory law.
5	Investor or provider frequently reneges on an offer after it has been accepted. This can legitimately happen when new information causes a policy to be valued differently or have limiting contingencies. But frequent reneges are abusive.	Press for facts supporting a renege. If a price is lowered or withdrawn, look for confirmation from other investors or providers.	Breach of contract and violation of insurance regulatory law.

Figure 9-.2 (cont'd)

	Abuse/Problem	Detection/Avoidance	Legal Ramifications
6	Intentionally wrong or incomplete advice by agents, financial advisors, attorneys, trustees or brokers to seller/insured regarding economics, reasons, benefits, alternative options, etc, for selling or not selling a life insurance policy.	About the only ways to eliminate such abuse is to (a) send comprehensive and clear disclosures to the seller/insured, and (b) conduct a phone interview with the seller/insured and ask questions regarding their understandings and motivations to sell.	Breach of fiduciary duty or fraud and violation of insurance regulatory law.
7	Excessive or abusive tracking of insured status.	Most state regulations stipulate limits to contacting the insured, e.g. once per quarter until the last year of the estimated life expectancy, then monthly. Avoid invasive procedures. Keep it simple.	Violation of insurance regulatory law. And perhaps invasion of privacy.
8	Not protecting insured confidential information. Agents, brokers, providers, investors, trustees, escrow agents, etc. selling the seller/insured identification information or sharing it with non-related parties.	Keep all such information secure. Be alert to anyone who seems too willing to share confidential information, or if they talk about the value of their lists. Cease business with such parties to avoid being associated with such abuses.	Negligence and violation of insurance regulatory law.
9	Brokers and/or agents double dipping in fees and commissions, i.e., charging the seller/insured and concurrently being paid by providers and /or investors.	Be alert to brokers or agents who ask for all funds to be paid to them rather than paid directly to each party in the transaction. Advise all parties that all fees and commissions paid by others must be disclosed and that double payments will not be allowed.	Breach of fiduciary duty or fraud and violation of insurance regulatory law.
10	Agents, brokers and providers requesting excessive illustrations, verifications and other information from insurers.	Such overload on insurers causes wasted time and frustration, resulting in resistance and even backlash. Carefully construct accurate and meaningful requests to avoid repeated requests for information.	Potential violation of insurance regulatory law.
11	Agents churning policies with insured for the purpose of generating commissions.	Churning policies is illegal and abusive to the insured and insurers. Insured can be alert to and separate from agents who frequently suggest surrendering or lapsing a policy in favor of applying for an new policy having lower cost or better terms. Insurers can be and try to be alert to policy applications where the prior policy, if properly noted, was issued within 1-2 years prior.	Breach of fiduciary duty, fraud or misrepresentation, breach of agency agreement with carrier and violation of insurance regulatory law.

Figure 9-.2 (cont'd)

	Abuse/Problem	Detection/Avoidance	Legal Ramifications
12	<p>Past abuses that hopefully have ended:</p> <ul style="list-style-type: none"> • Payoffs for false L.E.s • Kickbacks to agents • Not paying full amounts to seller • Delaying payments • Selling false policies to investors 	<p>Just be alert and don't think about participating or initiating any such practices.</p>	<p>Breach of fiduciary duty or fraud and violation of insurance regulatory law or federal and/or state securities law.</p>
13	<p>Insured has legitimate life insurance needs but incurs loss of needed life insurance coverage because agent convinces policyholder to sell where there is no valid reason to sell.</p>	<p>Carriers and regulators consider this abusive of the insured. The only way to discover and/or prevent it is to be alert to pragmatic evaluation of insured information and by asking relevant questions in interviews.</p>	<p>While this may not be specifically banned by regulations, it is an abuse of the insured and may give the insured and beneficiaries grounds for recovery actions.</p>

1. Insurer Abuses and Problems

Most problems and abuses stemming from life insurers involve some form of life settlement transaction delay or interference. Results of delays hurt policyholders and insureds by delaying payments to them because no payments are distributed from escrow until the ownership transfer of the life insurance policy is confirmed by the insurer. It is not in the insurers' best interest to abuse life settlement transactions because it backfires on their relationship with policyholders and insured and the life insurance agents that also serve as life settlement intermediaries. Sometimes, however, such transaction delays, while not uncommon, may often just be clerical errors.

2. Policyholder and Insured Abuses

A major source of problems and abuse in the life settlement industry stems from policyholders and insureds, sometimes with encouragement from their life insurance agents who stand to receive higher compensation in the life settlement transaction because of such problematic or abusive behavior. The motivation is to skew the insured's health and policy information such that the price offered for the purchase of the policy will be higher. Of all the problems and abuses that occur in life settlement transactions, those caused by policyholders and insured are

the most numerous and frustrating to industry operators.

3. Premium Finance and STOLI Abuses and Fraud

Premium financing is not a problem per se, but Stranger Originated Life Insurance (STOLI) policies are a problem. As of 2008, both the National Association of Insurance Commissioners (NAIC) and the National Conference of Insurance Legislators (NCOIL), along with life insurers and the life settlement industry, have sought to ban STOLI policies. STOLI is considered an abuse of the insured, abuse of insurers, and abuse of the social purpose of life insurance. However, policy owner use of life insurance policies as collateral to secure policy premium loans or financing for other purposes is a good use of life insurance and is not prohibited. The problem arises in distinguishing STOLI policies from other financing arrangements.

If a life insurance policy application asks the question, "Have you discussed the possibility of a life settlement?" and the applicant answered "No", but the policy has been used as collateral to secure a loan to pay premiums, is it a STOLI policy or not? Only an in-depth review of all financing documents can identify such, and even then some of these reviews do not reveal if it is or is not a STOLI policy. However, if the policyholder or lender resists providing copies of all financing documents to a life insurer for its consideration of a life insurance application, it

Figure 9.3

TABLE 3 – INSURER ABUSES AND PROBLEMS			
	Abuse/Problem	Detection/Avoidance	Legal Ramifications
1	Intentionally slow at providing illustrations. This delays ability to promptly and efficiently serve policyholders.	3-5 business day response is reasonable for production of typical illustrations. Unique and complicated illustrations may require 5-10 business days. Longer responses may be abusive. Building good business relations with insurer is best solution, else lean on the agent and persistently follow-up	Intentional interference with a contract and violation of insurance regulatory law.
2	Not providing illustrations as requested. Some insurers try to provide only their standard illustrations and resist illustrations that show specific policy assumptions.	Be sure to not request illustrations that include assumptions not possible for the specific policy. Be sure specific and clear instructions are given to the insurer. If the insurer is being difficult, keep pushing, knowing that each additional failure to illustrate may be considered an abuse.	Intentional interference with a contract and violation of insurance regulatory law.
3	Delaying policy validations. For newer policies that are in good-standing, validations should be almost instant, certainly not more than 3-5 business days. But for older policies, policies that have previously changed ownership or that have lapsed and been reinstated, validations may take several weeks. Any longer times and certainly delays in advising why a validation is delayed may be abusive.	Know the policy circumstances before asking for validation and be realistic, but be sure to obtain validation to assure accuracy of information provided by policyholder. Follow up and be persistent. If the information does not validate, dig in to it ... most often a simple mistake has been made by someone in the information chain. But, be alert to possibility of fraud.	Intentional interference with a contract and violation of insurance regulatory law.
4	Interference and scare tactics occur when an insurer is notified of a life settlement transaction and they immediately send a comprehensive “warning” letter to the policyholder loaded with stern talk about options, concerns and legal warnings.	Such “warning” letters are arguably provided to assure full disclosure, however, most state regulations require agents, brokers and providers to provide such disclosures. The best way to avoid impact of such letters is to provide full disclosures and education to the policyholders early in the process.	Intentional interference with a contract and violation of insurance regulatory law.
5	Delay the recording of the policy ownership on insurer records.	Most states require such transfers to be completed within 30 days.	Intentional interference with a contract and violation of insurance regulatory law.
6	Insurer fails to disclose in the policy verification that a collateral assignment exists and allows the policy to transfer to the investor with a senior collateral lien on the policy.	This can lead to a major loss to the investor if the senior lien seeks payment from death benefits before the investor. All documents have to be checked in-depth, but in the end, the transfer request to the insurer should stipulate that the policy can only be transferred free and clear of all liens, thus making the insurer responsible for the error.	Fraud or negligence and violation of insurance regulatory law.

Figure 9.4

TABLE 4 – POLICYHOLDER AND INSURED ABUSES			
	Abuse/Problem	Detection/Avoidance	Legal Ramifications
1	Fraudulent medical records such as: using records of a relative with false social security number.	This can be best avoided by refusing medical documents provided by the seller, insured or their agents, but rather directly request medical providers for records.	Fraud and violation of insurance regulatory law.
2	Using different doctors, laboratories and hospitals, i.e., one for actual treatment and others for display of a health status that provides advantage to the seller.	Be concerned if the insured claims to never have visited a doctor. Look for gaps in treatment. Ask medical providers for names of other providers.	Fraud and violation of insurance regulatory law.
3	Insured provides different information to insurers and to life settlement providers.	Be alert to illogical facts, for example: an 82 year old insured woman qualified for a \$7 million policy having a premium set at better than normal health, and then within two years obtains a life expectancy report showing a life expectancy of three years with no intervening major medical development. This is evidence of probable fraud ... either by the insured, or by the life expectancy provider, or by the agents representing the insured.	Fraud and violation of insurance regulatory law.
4	Trustees and/or family members having power or ownership of a policy to execute the sale without the insured knowing ... may be technically legal, but certainly is an abuse of the insured because it affects the insured's insurable capacity and the continued tracking of the insured for life.	Be alert to the insured's status, and if possible, arrange for an interview with the insured. Certainly be concerned if the family resists such interview. Can also ask medical providers if the insured is capable of making decisions and participating in an interview.	Potential negligence.
5	Intentionally using the 15 day rescission period in a typical transaction to break a closed deal and accept a better offer that came in late. While some state laws allow for this, it is abusive of the marketplace and causes brokers, providers and investors to waste time and money in the transaction.	A deal should be done when signed or subject to some cost recovery if the seller rescinds it for a better deal. Of course this is different from the seller who had not been fully informed and later resolved to not sell the policy. Again, the best avoidance is to make sure all documents are signed by the policyholder and insured, and to interview them.	Probably none.
6	Intentionally hiding information from the buyer, such as collateral assignments on the policy, or newer medical exams reporting that prior health problems are resolved.	Be alert to incomplete forms and repeated efforts to get all the information, or to the person who complains too much about all the required information. Design forms with intentional redundancy of information to be cross-referenced.	Fraud and violation of insurance regulatory law.

Figure 9.4 (cont'd)

	Abuse/Problem	Detection/Avoidance	Legal Ramifications
7	Intentionally submitting incorrect or incomplete insurance documents and illustrations to brokers and providers to get a price and deal and then when the real facts surface, negotiate a compromise price.	Known as “bait and switch”, the typical strategy is to get an unreal initial high price and when the facts are all in, cause the buyer to compromise. Best way to avoid this is to simply refuse the deal when the real facts are discovered.	Fraud and violation of insurance regulatory law.
8	Incomplete insurance policies given to providers such as poor quality photocopies or pages missing that contain special riders that would make the policy less desirable.	Not only does this slow the process and increase processing costs, it risks creating errors that can later cause a deal to break. The best detection and avoidance is to get policy validation from the insurer. Can also press agent for other copies of the policy.	Potential misrepresentation or breach of contract.
9	Not providing the death certificate to the buyer/owner in a timely manner. Sellers agree to provide death certificates, but survivors may not be aware of the third party policy owner.	Looking up deaths in public records is costly, results in delays and can be missed. Good communications and relations with the insured and family is the best way to get timely information.	Breach of contract or intentional interference with contract.
10	Heirs filing claims for policy death benefits years later, claiming they did not understand, etc.	Courts have found in favor of the buyer in most cases. The best avoidance is requirement for all policy beneficiaries to sign releases and to assure that they did personally sign the releases.	Potentially frivolous litigation.
11	“Snowbirds” not making clear the state of the policy domicile. May or may not be intentional abuse, but certainly causes problems and can appear to be fraud.	Issue is which state law applies and often transactions must be totally redone when state of policy domicile is discovered to be different. Cross-reference IDs, insurer validation and application forms.	Potential misrepresentation or breach of contract.
12	Policy owner recently changed residences to another state but has not notified insurer.	Cross-reference driver’s license can identify the problem. Problem can be worse if policy owner has not released prior residence as his/her primary residence.	Potential fraud or misrepresentation or breach of contract and violation of insurance regulatory law.
13	Recent change of policy ownership to a seller in a different state, such as, policy transferred to ownership of a spouse, child, other relative or a business partner.	Check dates and verifications from insurer. Look for chance such change was solely to avoid certain state regulations. Interview old and new policy owner and the insured.	Potential fraud or misrepresentation or breach of contract and violation of insurance regulatory law.
14	Relocating the domicile of a trust (policy owner) for the sole purpose of facilitating a policy sale.	Check dates and verifications from insurer. Look for chance such change was solely to avoid certain state regulations. Interview trustee and the insured.	Fraud and/or breach of contract and violation of insurance regulatory law.

Figure 9.4 (cont'd)

	Abuse/Problem	Detection/Avoidance	Legal Ramifications
15	Policyholder (seller) does not pay premiums when due during the closing period, i.e., from acceptance of a life settlement offer and closing. This can cause the policy to lapse and can materially change the purchase price of the transaction.	This requires careful attention during the closing process, and it requires re-verification of the policy status prior to distribution of settlement funds from escrow. Deal papers should stipulate who pays the premiums from deal acceptance to closing, and what the policy account value must equal or exceed at closing.	Fraud or misrepresentation and breach of contract.

is probably safe to assume it is a STOLI transaction. And it is best to avoid doing business with such a policy. But most STOLI policies were issued before the newer laws or before the insurer inserted questions in the policy application to uncover and filter out STOLI and so these policies are exempt from the newer STOLI limitations and insurers cannot refuse paying the policy death benefits.

If a life insurance policy being tendered for a life settlement is collateral for a loan, the following check-points should be completed:

- Was any upfront consideration paid by the lender, any of its affiliates or other person to the borrower (which is usually the policyholder) or the insured?
- Does the borrower have any economic interest in the policy's death benefits *beyond* settlement of the outstanding loan?
- Does the borrower control ownership of the policy via a trust, partnership, or LLC, including right to sell the policy?
- Did any of the loan documents or loan planning documents exist *prior* to the date of the policy's application or policy issuance?
- Do any documents suggest a plan or intent to sell the policy within two years from its issue?
- Was there an immediate change of policy ownership from the initial policyholder to a trust, partnership or LLC in which the lender has a material control, either right after the policy was issued or shortly after the two year contestable period?

If any of the above appear to have occurred, there is a high probability the policy is a STOLI and more in-depth discovery is needed or the policy should be avoided.

Note that some state laws as of 2008 deem the solicitation, application and issuance of a STOLI to be a fraudulent violation of state laws, subject to felony penalties.

4. Legal Remedies

In the insurance area, including life settlements, there are three basic forms of legal redress:

First, there are civil litigation remedies that an aggrieved policy seller or insured may use to recover damages against life settlement providers or brokers or other intermediaries that have committed a breach of contract (such as a life settlement agreement) or tort (such as a breach of fiduciary duty or negligence or fraud) against the policy seller or insured.

Second, in states that regulate life settlements, the state insurance departments can impose fines and/or suspend or revoke licenses issued to life settlement providers or brokers for their violations of the life settlements laws and regulations (and in some states other provisions of the insurance code). Generally, the insurance regulatory laws do not provide private litigants with a private right of action based on a person's violation of such a law, unless the law expressly provides for a private right of action. The NAIC's and NCOIL's model life settlement acts do not contain private rights of action.

Third, in some states certain proscribed conduct is the commission of a crime, which may be prosecuted by the state insurance department, attorney general, or local law enforcement depending upon

state law. Where there is federal law in play, such as securities laws, federal regulators and prosecutors have jurisdiction, which may be concurrent with state regulators and law enforcement.

Fraud and certain types of abuses in the life settlement industry are actionable torts, generally allowing the harmed person to recover monetary damages against the tortfeasor. In some cases, however, fraud may award the victim an equitable remedy such as rescission of a transaction to restore the parties to their status quo before the fraudulent act.

State insurance departments typically bring regulatory enforcement actions when a problem is brought to their attention in the form of a complaint. Holders of state department issued licenses, such as life settlement providers and brokers, are entitled to due process and can have their claims made by state insurance regulators heard in an administrative hearing. But, in many states the hearing officer is the insurance commissioner, whose office is also the party that has brought the enforcement action.

Most regulatory enforcement actions do not run a full course to a hearing and are administratively settled. In addition, state insurance departments conduct periodic market conduct examinations of holders of insurance licenses, and it is through these examinations that licensees become subject to corrective action requirements and/or fines for regulatory violations. If a regulatory violation is found to be willful, it carries a higher monetary penalty.

Both the NAIC's and NCOIL's model life settlement acts define fraudulent life settlement acts. These acts, which in some cases are punishable as a felony crime, include:

- knowingly or with intent to defraud presenting, causing to be presented or preparing with knowledge or belief that it will be presented to or by a viatical settlement provider, viatical settlement broker, financing entity, insurer, insurance producer or any other person, false material information, or concealing material information in connection with a life insurance or life settlement application,
- transacting the business of viatical settlements in violation of laws requiring a

license, certificate of authority or other legal authority for the transaction of the business of viatical settlements,

- recklessly entering into, negotiating, brokering, otherwise dealing in a viatical settlement contract, the subject of which is a life insurance policy that was obtained by presenting false information concerning any fact material to the policy or by concealing, for the purpose of misleading another, information concerning any fact material to the policy, where the person or the persons intended to defraud the policy's issuer, the viatical settlement provider or the viator,
- facilitating the change of state of ownership of a policy or the state of residency of a viator to a state or jurisdiction that does not have a law similar life settlement law for the express purposes of evading or avoiding the application of a life settlement law and
- engaging in STOLI transactions.

The life settlement laws require that life settlement providers maintain and adhere to an anti-fraud plan designed to detect policyholder or insured fraud in the original purchase of a life insurance policy and report suspected fraud to state insurance regulators. These laws also mandate the life settlement providers provide a fraud warning to policy sellers and insureds as follows:

"Any person who knowingly presents false information in [an application for insurance or viatical settlement contract] [a viatical settlement purchase agreement] is guilty of a crime and may be subject to fines and confinement in prison."

Most of the criminal cases involving life settlements have occurred in the offering of unregistered securities in the form of investments in fractional interests in life settlement policies. Examples of these types of cases include the prosecution of C. Keith LaMonda, Jesse W. LaMonda, and John L. Maynard in which the three defendants were convicted of federal securities fraud and sentenced to 20, 13 and 10 years in prison respectively. In two other related well publicized viatical investment securities fraud cases, Stephen L. Keller and Robert Grant Sutherlin were convicted of violations of federal securities and money laundering laws and received lengthy prison sentences. Mr. Keller fled the United States after losing his case and was later captured.

SUMMARY

It would be wise for all parties to life settlement transactions to avoid any of the abuses, problems, or fraud actions noted in the above sections.

Abuses and problems remain a concern for all life settlement industry stakeholders: operators, policyholders, insureds, insurers, regulators, and legislators. Organizations like the NAIC and NCOIL have worked hard to create “model acts” that attempt to regulate life settlements such that abuses and problems are minimized. Their regulatory intent is generally good, and many abuses and problems found in the early years of the life settlement industry have been curtailed, but many opportunities for abuses and problems remain uncontrolled.

In 2007, STOLI was deemed to be an abuse, and new laws adopted by some states and proposed in many other states attempt to make STOLI policies illegal. And as of 2008, one state, West Virginia, makes any violation of the state life settlement laws a felony punishable by prison time. This is deemed by many as a law that is abusive to the industry and to consumers in West Virginia.

Industry operators’ best approach to avoid abuses is to establish thorough and prudent transaction forms and procedures to check and re-check all information while a life settlement is being evaluated. They should interview policyholders and insureds. Require copies of all loan or other financing documents. And, compare information and use common sense in judging if all information corroborates other information.

Policyholders and insureds can avoid abuse:

- Assure that the transaction is handled by well known financial institutions, e.g., Wells Fargo Bank, etc.
- Avoid transactions using offshore escrows and trustees.
- Have an independent and competent lawyer review the transaction documentation for unreasonable terms.
- Use personally known agents and advisors.
- Make sure the agents and advisors discuss and explain alternatives to selling a policy, including the best timing to sell.

QUESTIONS AND ANSWERS

Question – Are life settlement laws and regulations fair to consumers?

Answer – This answer depends on your perspective. For the most part, laws and regulations are written to protect consumers, but some are also written to protect business. Any law or regulation written to favor one constituent over another is unfair. But laws and regulations designed to prevent predatory practices on naive and uninformed consumers by business are just. The emergence and expansion of the life settlement industry have pressured state legislators to write regulatory laws and the NAIC and NCOIL have proposed model laws for the states. Most of these laws and regulations are intended to be fair, but are in various stages of implementation, meaning that their ultimate effects are not fully known. Some remain subject to legal challenge. For example, can a law impose a five year ban on selling a personal asset, particularly a policy that is in-force when the new law takes effect?

Question – Should there be more regulation of life settlements?

Answer – This brings up the proverbial question: Can government regulate better than business? Will business regulate itself? Life settlements need to be regulated in all states for the protection of consumers. Regulations should not create regulatory advantage of one industry participant versus another, e.g., insurers versus life settlement providers, lenders versus insurers, or investors in life settlements versus investors in securities. In their zeal to get laws and regulations established, some states have not kept up with implementation, are under staffed, or are implementing or enforcing with bias. Some states are limiting financial opportunity for their residents by overly controlling or constricting competition. Life settlement laws and regulations are relatively new and need time for evaluation and potential amendment, and some need to be challenged in courts to determine their validity.

Question – Can the life settlement industry operate efficiently within state regulation?

Answer – Yes, the life settlement industry will continue to operate within state laws and regulations. However, many industry operators will avoid certain

states, e.g., North Dakota and West Virginia, where laws and regulations are deemed by many to be excessive or anti-life settlement oriented. This type of regulation eliminates valuable opportunities for residents in those states. Some of the newer laws and regulations create market inefficiencies, but as is typical with regulations, amending and tweaking will flush out most poor practices.

Question – Would federal, rather than state, regulation of life settlements be more effective at controlling abuses?

Answer – Yes and no. Dealing with 50 different states' laws, plus Washington D.C. and Puerto Rico laws, makes operating businesses more costly, is less efficient for policy sellers, and has a greater risk of regulatory error. In some cases, it enables parties to "shop forums" to avoid more stringent regulation that would otherwise apply. It certainly increases overhead, pays more lawyers and reduces efficiencies. On the other hand, shifting regulation to the federal government would add another bureaucracy without experience in the regulation of insurance generally and with new learning curves, complexities and typical inefficiencies. The fact that insurers are regulated by states suggests that life settlements should be regulated by states. It has been suggested that the insurance industry (and thus including life settlements) should be structured similar to banking, wherein insurers would be given the option to operate under federal charter or state charter. However, the benefit of federal regulation over life insurance needs further research.

Question – Should there be more penalties for abuses and fraud in life settlements?

Answer – Fraud is something that should not be condoned and should be subject to serious penalty. However, operational oversights and clerical errors are not fraud, but they can become abusive if allowed to happen with regularity. Whatever penalty is appropriate, it should be of such magnitude to cause industry operators, insurers, and consumers to endeavor to pay attention and to do it right. Of course, state insurance commissioners generally have the authority and power to revoke licenses and to shut down insurers that are operating in violation of law.

Question – Has the media been fair to the life settlement industry and to consumers?

Answer – The media seems to focus on the "death" side of life settlements more so than the "economic benefits" provided to sellers or the "value added" to retirement planning and funding. According to the media, investors in life settlements hope the insured dies early. Well so do insurers who sell annuity contracts but the media has not labeled annuities as "hurry up and die" contracts. Furthermore, the media usually fails to mention that the longstanding principle of insurable interest in the life insurance context requires that insurable interest exist only at the time of policy issuance, so that the buyers of life settlements have not altered this rule, which has always embraced that subsequent owners of policies need not have an interest in an insured's continuing longevity. Life settlements provide numerous benefits to policy sellers, and the media could do the consumer public a great service by providing greater awareness and education in a more balanced manner.

Question – Are legal remedies adequate to assure fair treatment of consumers, industry operators, investors, and insurers?

Answer – In some states the civil, regulatory, and criminal laws applicable to the life settlement industry provide adequate means for redressing and deterring unlawful conduct. However, where state insurance departments are understaffed or do not have adequate experience or legislative power, they have difficulty in bringing enforcement actions in this area. Also, resources must be balanced against all their other priorities in the enforcement of insurance laws generally. However, with a more intense focus nowadays on the protection of seniors, both among state insurance regulators and legislators as well as the SEC and FINRA and state securities regulators, violators of life settlement laws will likely see more rigorous enforcement of these laws.

CHAPTER ENDNOTES

1. FINRA's Annual Examination Priorities Letter, available online at www.finra.org/web/groups/corp_comm/documents/home_page/p038169.pdf.
2. 87 F 3rd 536 (DC Cir, 1996).

